Notice No.: 98-001

Date: February 27, 1998

Applies to: All Employers

Subject: Changes to Excess Compensation Definition

Background

The excess compensation statute, Revised Code of Washington (RCW) 41.50.150, was amended by House Bill 1102 (Chapter 221, Laws of 1997) effective July 27, 1997. Changes regarding excess compensation apply to members of Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) and the Washington State Patrol Retirement System (WSPRS).

The amendment narrowed the scope of the law by limiting excess compensation to the types of payments specifically listed in the statute. The information in this notice supersedes Department of Retirement Systems (DRS) Notice 95-010, which described 1995 changes to excess compensation under RCW 41.50.150.

Excess Compensation Defined

Excess compensation consists of specific types of reportable compensation, when the payment increases the member's retirement allowance. If payment included in a retiree's retirement allowance calculation qualifies as excess compensation, then the applicable employer is responsible for the resulting trust fund liability. The employer is liable for the total estimated cost of all present and future retirement benefits attributable to the excess compensation. For further information regarding how a retirement allowance is calculated, refer to the appropriate member handbooks.

Excess compensation includes the following payments, when used in the calculation of the member's retirement allowance:

- A cashout of more than 240 hours of annual leave;
- A cashout of any other form of leave ;
- Any payment that exceeds twice the regular daily or hourly rate of pay;
- A payment for, or in lieu of, any personal expenses or transportation allowance, to the extent that the payment qualifies as reportable compensation in the member's retirement system; or
- Any termination or severance payment.

Refer to RCW 41.50.150 for specific language. These payment types are discussed in more detail below.

What is Leave Cashout?

A leave cashout is any compensation added to wages or salary that is paid along with a reduction of the employee's leave balance. Annual leave cashouts are reportable only for members of PERS Plan 1, TRS Plan 1 and WSPRS.

The following leave cashouts will result in an excess compensation invoice to the applicable employer if the cashouts increase a member's retirement allowance:

- A cashout for more than 240 hours of annual leave.

  Annual leave is leave provided by an employer for the purpose of vacation. Annual leave does not include leave for illness, personal business (if in addition to, and different from, vacation leave) or other paid time off from work. The one exception is when an employer authorizes only one type of leave to provide paid leave for vacation and illness, as well as any other excused absence from work. In this situation, the multi-purpose leave will be considered annual leave and will only be considered excess compensation if it exceeds 240 hours.

- A cashout of any other form of leave, such as sick leave, regardless of amount.

  In characterizing leave cashouts, DRS will disregard any conversion of leave by an employer from one form to another and will consider the leave to be what it was when originally earned. If compensation for the original form of leave falls under the definition of excess compensation, the employer will be responsible for paying the resulting excess compensation invoice. Sick leave cashouts are reportable for PERS Plan 1 and TRS Plan 1 members. Sick leave cashouts for a state agency or an education employer are not reportable compensation.

- Any payment added to salary or wages in lieu of accrued leave.

  An employee reaches his or her maximum leave balance. Instead of accruing leave, the employee is paid the equivalent of the leave he or she would have earned. This is considered a leave cashout and is considered excess compensation if the total leave cashout exceeds 240 hours in his or her average final compensation (AFC) period.

Payments for Additional Time Worked

Following is an example in which a payment for additional time qualifies as excess compensation:

> **Example:** A one month project is assigned to a current employee and the rate of pay is three times the employee's regular rate of pay. The amount of pay that exceeds twice the regular rate of pay would be considered excess compensation if used to increase the member's retirement allowance.

Following is an example in which a payment for additional time does not qualify as excess compensation:

> **Example:** An employer's policy grants Presidents' Day as a paid holiday for all employees. Due to an emergency, an employee is called to work on Presidents' Day and works a full shift. The employee receives two and one-half times the regular rate for working on that day; e.g., one day's pay for the holiday, and time and one-half for the overtime hours worked. Because the pay for the holiday is for regularly scheduled time, that portion of the day's compensation is not overtime; the employee's actual overtime rate is time and one-half. In this example, none of the pay received by the employee for working on Presidents' Day would be excess compensation.

If the employee's regular salary is not expressed in terms of a daily or hourly rate, DRS will divide the employee's regular annual or monthly salary by the number of regularly scheduled work days or hours in the work year or month. In calculating the number of regularly scheduled work days or hours in a work year, DRS will include all paid holidays and paid leave days, excluding days cashed out.

Can Vehicle Allowances Be Excess Compensation?

Generally, a vehicle allowance is not reportable compensation. A vehicle allowance is sometimes paid to an employee in place of mileage reimbursements for using a personal vehicle while providing services to an employer. Because the payment is a reimbursement rather than salary, it is not a payment for services rendered and is not reportable.

However, if the employer keeps records that demonstrate that the vehicle allowance exceeded the employee's actual expenses, the portion of the allowance that exceeds actual expenses is reportable. The reportable expense would be excess compensation if it was paid during the compensation period used to calculate the retirement benefit. Refer to WAC 415-108-480 for PERS and WAC 415-112-41301 for TRS.

Does Severance Pay Qualify?

Severance pay may or may not qualify as reportable compensation, depending on whether it was earned for services rendered. Severance pay is reportable only for members of PERS Plan 1, TRS Plan 1 and WSPRS. If severance pay qualifies as reportable compensation, and the member's retirement allowance is increased, it will result in an excess compensation invoice to the applicable employer.

- <u>Reportable</u>:

  Severance pay must be earned over time in the same manner as annual leave or sick leave in order to be reportable compensation for services previously rendered. Severance pay is earned over time if the employment contract(s) entered into at the beginning of the period of employment specifies the amount of severance pay to be earned in the coming year in consideration for services rendered.

  > **Example:** Mr. Jones is a school administrator. Since the beginning of his term of employment with the district, his contract has specified that he will earn one week of severance pay for every year of his employment. The earned severance pay will be paid at the time of his separation. His severance pay is reportable compensation. When Mr. Jones retires, the two weeks severance pay he earned during his two highest paid years (i.e., one week per year for two years) will be included in his retirement calculation and considered excess compensation.

- <u>Not Reportable:</u>

  Severance pay that is not earned over time is not earned for services rendered and is not reportable. Because such payments are not reportable compensation, they are not excess compensation. An example of severance pay not earned over time is a payment negotiated as part of a termination agreement.

When to Notify the Public About Excess Compensation

When a PERS or TRS employer proposes to enter into a contract with an employee or group of employees that may result in an excess compensation billing, the employer must identify the compensation provision and the potential cost for excess compensation at an open public meeting. This notification may be part of the approval process for adopting a contract in whole and need not take place in separate or additional open public meetings. This requirement became effective July 23, 1995; refer to RCW 41.50.152.

At the public meeting, the employer must provide the following information:

- Full disclosure of the nature of the proposed compensation provision. This would include an explanation of the pay provision and the services the employee is being compensated for.

- An estimate of the cost of the excess compensation billing that the employer would have to pay as a result of the proposed compensation provision. On request, DRS will provide information on how employers can develop the estimate.

When DRS bills the employer for the excess compensation, the employer must notify DRS of its compliance with the public notice requirement.

Questions?

If you have additional questions about excess compensation or the public notice requirement, contact Jack Bryant, PERS Administrator, Leah Wilson, LEOFF and WSPRS Administrator at (360) 709-4700 or Margaret Wimmer, TRS Administrator. To use the toll free menu selection system to reach a DRS staff member, call 1-800-547-6657.

John Charles
Director

1997 DRS Notices

For a copy of a Notice, call (360) 586-4515.

Notice No.	Applies to/ Subject matter
97-001	**All Employers** Summary of 1997 Legislation.
97-002	**All Employers** New Reporting Procedures When Hiring Retirees
97-003	**All Employers** Contribution Rate Changes
97-004	**All LEOFF Employers** New Sections to WAC 415-104/Basic Salary for LEOFF Members
97-005	**All TRS Employers** Members' Annual Statements and Sequencing Information
97-006	**TRS Plan 3 Employers** Processing the 40 Percent Transfer Payment
97-007	**All Higher Education Employers** Multiple PERS Employment
97-008	**All TRS Employers** Processing TRS Plan 3 Member Information
97-009	**Political Subdivision Employers** Deferred Compensation Program
97-010	**PERS, LEOFF, WSPRS AND JRS Employers** Members Annual Statements and Sequencing Information